

THE PATIENT PROTECTION AND AFFORDABLE CARE ACT

Overview: A Better Health Care System?

The Patient Protection and Affordable Care Act (PPACA of “health care reform”) is sweeping legislation that will affect economic activity far beyond the one-sixth of the U.S. economy identified as health care sectors. The health care reform includes individual and firm-level mandates for health insurance coverage, extensive insurance industry regulations, creates new state-level programs and obligations, two new large federal entitlement programs, and dozens of new federal boards and commissions.

The recently enacted PPACA will substantially transform the U.S. health care system. These changes will occur over time, however. The most significant changes (e.g., a requirement that most people obtain health insurance) will not become law until 2014. A tax on employee “Cadillac” health plans does not take effect until 2019.

Impact on Businesses

1. **Higher Health Care Costs.** The Patient Protection and Affordable Care Act does little or nothing to “bend down the cost curve” that small businesses face relating to providing health insurance coverage. In fact, it is likely that the endless regulations, mandates, fees, and taxes will put upward pressure on premium prices—particularly in the “fully insured” market, where 88 percent of workers and dependents at small businesses purchase health insurance.

From the employer perspective, the most celebrated aspect of the PPACA is its mandate to cover employees with health insurance. Focusing first on those employers with more than 50 workers, beginning in 2014, those firms must pay a penalty if any of their full-time workers receive subsidies for coverage through the exchange.

The penalty is equal to the lesser of \$3,000 for each full-time worker receiving a premium credit, or \$2,000 for each full-time worker, excluding the first 30 fulltime workers. The fees are paid monthly in the amount of 1/12th of the specified fee amounts. Firms with fewer than 50 employees are exempt from the so-called employer “play or pay” penalties if they do not offer coverage and their workers receive a government subsidy in the exchange.

2. **Limited Small Business Tax Credit.** Even accounting for the “cost-reducing” tax credits – which the Congressional Budget Office estimates will impact at most 12 percent of businesses with 25 or fewer workers and expire after two years beginning in 2014 – PPACA will not address the many uncertainties small businesses face in deciding whether to offer health insurance coverage to its workers.

Essentially, after all exclusions the only eligible firms for the heralded “small business tax credit” are those with 10 or fewer workers and those with low income workers – and most of these workers will qualify for premium subsidies in the state exchanges. These small firms are the least likely to offer coverage even with a significant price reduction.

3. **Higher Regulation Compliance Costs.** Small businesses do not have the capacity to easily take on additional administrative complexities. Many small companies will have to hire additional workers – and incur higher external accounting expenses – to handle not only the enhanced compliance regulations on health insurance plans but also stricter tax compliance regulations relating to business-to-business transactions.

Perhaps the most expensive and intrusive new cost on small business is contained in Section 9006 of the PPACA. This adds a new information reporting requirement mandating that business will have to issue Forms 1099 for goods purchased after 2011, regardless of the corporate form of the vendor.

Vendors of goods will have to furnish, and business will have to collect Tax ID numbers for all aggregate purchases totaling over \$600 annually. If a vendor fails to furnish a correct Tax ID, the business receiving the goods is required by law to impose back-up withholding at the rate of 28 percent of the purchase price. This means that businesses will now have to keep records of all purchases and keep them sorted by Tax ID.

The health care reform's 1099 provision would apply to businesses of all sizes, charities and other tax-exempt organizations and government entities. Based on tax returns filed in 2009 for tax year 2008, more than 41 million organizations will now need to submit 1099 forms.

4. **Medicare Taxes on “Flow-Through” and Investment Income.** The PPACA will increase the Medicare payroll tax and establish a new Medicare non-payroll (“investment”) tax. This tax will apply perversely on “flow-through income”—thus reaching a significant share of small businesses. Moreover, the wage thresholds on this tax increase are not indexed to inflation and, consequently, will push more small business owners into this higher tax group. The Medicare “investment” tax will also lead to greater deterrence on investment – and passive income – which will suppress economic growth.

Summary and Conclusion

This short paper has reviewed the provisions of the PPACA from the perspective of the direct and indirect cost implications for small businesses. We find that the reform's mandate will raise overall costs, and that the structure of the mandate and tax credit will raise effective marginal tax rates on small business growth and expansions. In addition, the burdensome and intrusive 1099 reporting requirements will burden firms, alter the customer relationships in the small business market, and impose potential strains on employee relations in the small business sector.

These costs pressures will be exacerbated by the indirect effects of the reform. Small businesses will face unmistakable upward pressures on health insurance premiums and the need to re-work benefit packages. Indeed, in the extreme some may choose to exit providing insurance altogether. Simply mastering the information necessary to make these decisions will be a substantial hurdle for many small businesses.

As businesses react to the changed economic landscape, there will be natural incentives to attempt to shift the higher costs to customers, workers, or business capital. At least for the near term, the ability to charge higher prices appears limited. Instead, one would expect that the effective burden will be borne by workers in the form of lower wage growth, fewer hours, or even reduced job growth. If not, the burden will fall on scarce business capital, raising the prospect of increased failure rates of small businesses.

As the review makes clear, far too little is known regarding the magnitudes of many of the costs and resultant adjustments. An important agenda for the research community is to follow the evolution of the new law and provide accurate measurement of its actual impact.

The West Virginia Chamber of Commerce will continue to monitor and comment on the implementation of the Patient Protection and Affordable Care Act.